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Is the Garbage Tax Increase Justified?

Georgi Angelov

Recently we understood that the Municipality of Sofia discusses a possible (and very probable) increase of the garbage tax (or garbage fee, as it is called). This increase will happen because of the proposed growth of the taxable values of the real estate which growth will not be fully compensated by decrease of the garbage tax rate. The justification for this policy is the need of more money for cleaning the streets, collection of garbage and its transportation and storage (or burning). Critics of this policy point out that Municipality of Sofia pays more money for cleaning and collecting garbage than other comparable cities and still the city is not clean enough and there is a permanent shortage of money for these activities.

Collection of garbage

The collection of the garbage in Sofia and the other municipalities is financed by the garbage tax. Essentially, the garbage tax is a tax on the values of the real estate. Therefore, there is no connection between the garbage that is disposed by the owner of the property and the tax paid by him. The collection of the garbage is done by companies that have concession contract with the municipality of Sofia. Each company has a

monopoly for collection of the garbage in its region.

We can see several problems with this arrangement of the garbage collection:

- No connection between the disposed garbage and the garbage tax paid
- The garbage tax is set by administrative decision
- The garbage collecting companies are selected by administrative decision
- No competition and existence of a real monopoly
- No incentives for efficiency – because of the lack of competition

What can be done to solve these problems?

Instead of continuing the current system that leads to a constant increase of expenditures, some changes in the system can be designed. One possible reform is decentralization of the garbage collection, which is used in some European countries. These are the general principles of the decentralized system:

1. People living in a block of flats (or commercial company owning real estate) choose the company that will collect their garbage. They are free to choose any company they want.

2. The price for garbage collection is negotiated between the garbage collection company and the people, living in the block of flats (or the company owning the building).
3. The timing of the garbage collection is also negotiated between the two sides of the contract.
4. The garbage tax is revoked.

As a result the garbage collection fee will be negotiated and paid on market terms and it will depend entirely on the quantity of the garbage disposed. The garbage collection companies will be many and they will compete which will drive prices down to the market levels. Garbage tax will disappear.

Storage and burning of the garbage

Another problem that requires a lot of expenditures is connected with the storage and burning of the garbage. A factory for burning the garbage must be built and this requires a lot of money. One possible solution is to increase the property taxes (including garbage tax) in Sofia. The other variant is much better – the Municipality of Sofia can sell some of its assets and increase the efficiency of its expenditures; then it can use the proceeds for building the required factory.

There are several possibilities for financing the factory:

- Privatization of “Municipal Bank” and “Municipal Insurance Company”
- Optimization of the administration
- Privatization of “Sofia Real Estate Company” (Sofiiski Imoti) as well as buildings, land, offices that are property of the municipality
- Elimination of the useless Municipal Guarantee Fund for Small and Medium Enterprises
- Privatization of central heating company, city transport, protection company “Egida”, hospitals and medical institutions
- Introduction of competitive public procurement for expenditures and ensuring full transparency of the municipal spending

The usage of all these possibilities for financing will help avoiding the increase of taxes for financing the garbage-burning factory.

Conclusion

When public spending is discussed there is a constant need for searching for more efficient decisions. In the case of Municipality of Sofia such solutions are the decentralization of the garbage collection and financing the garbage-burning factory by selling other municipal assets. If these two things are done, the result will be abolition of the garbage tax and ecological (and cheap) destruction of the garbage.

Social Assistance – For How Long?

Svetla Kostadinova

Social assistance payments are considered as a way by which the state can help people who cannot receive income by work or possession of property. Unfortunately, we are witnessing abuse of the system by certain groups in society for years. The current law for social assistance has numerous requirements and provisions for who is entitled to such payments. As well there is a separate state agency that administers and monitors welfare payments. The law however does not stipulate for how long such help can be granted.

What is the result? While unemployment benefits have a limitation period according to length of service, the welfare payments do not. The proposed change by the labor ministry for introducing a certain period for receiving welfare assistance is a wonderful initiative. The planned change however has two major defects.

First, one of the expected changes is to introduce a maximum period for receiving social welfare payment of up to 18 months. This means that people of working age that receive such social payment will have the right to receive them longer than unemployed people with the longest length of service (over 25 years), because the latter are entitled to a maximum of 12 months of unemployment benefits according to Social Security Code.

On the other hand, it appears that one year after the social payment is suspended people will be able to reacquire it. In reality the change consists of termination of participation in the system for one year and nothing more or less. This, of course, will turn out some of the false participants but is not a long-term decision of the problem. Most of these people have other incomes and can sustain their existence without welfare payments. And there is nothing that is easier than filing a claim for payment in one year time. The knowledge that you will classify for social welfare payments after a one-year period cannot be compared with the perspective of not participating in the system after defined cumulative period of time or in the case of cheating or misreporting.

To be truthful we have to say that there are certain provisions in the law that are grounds for dropping out of the system, i.e. refusal of unemployed to participate in programs organized and financed by the labor ministry. Anyway, such provisions are most often easy to avoid, and if applied last for a short time. In other words, if you know the system well you can take advantage of state's generosity for years (backed by taxpayer's money).

What should be done?

1/ Put into practice one of the basic principles laid in the law on social assistance which is *"Receiving of monthly social welfare payments is bounded by expanding socially useful work"*.

2/ Removal of the possible restoration of the right to social payments after a defined period of time, or if there is such restoration it should be at least five years after its imposition.

3/ Acceleration of the process of transferring the responsibility of social support from central administration to municipalities. Monitoring and control on local level can give amazing results.

4/ Introduction of a maximum period for social payments in one person's lifespan. Some states in the USA have introduced limitation of 60 months total for social payments per person in the course of his life. The results were amazing – the claims for assistance dropped 65% and stabilized on low level despite rising of unemployment in different periods.

In the end, we can define some basic principles that should be implemented if quick and radical reform is begun. These principles will optimize expenditures, will bring back many of the long-term "customers" to the labor market and will make possible to grant dignifying assistance for those who really need it.

- For those who can work – assistance only for work – the motives are both economic and practical;
- Everyone who is applying for social assistance should be regarded as able to work until all possibilities are exhausted;
- The assessment of the results of the proposed by should be made via comparison with those who are employed. Often, the opponents of the proposed system argue that social payments will be less than the current ones. We can only say that social welfare payments should be compared with income of one normal working family but not with those of the past social assistance system. The expected drop out of false recipients and their inclusion in the labor market will benefit society.

Bulgaria and the IMF again Dimitar Chobanov

The unofficial visit of Hans Flikenschild, the head of the International Monetary Fund (IMF) mission to Bulgaria, has ended. During this visit discussions with Bulgarian officials were made about their policies at the end of 2005 and in 2006. According to the public information there had not been an agreement on some crucial issues and further talks are needed.

According to Mr. Flikenschild, the current account deficit (CAD) is a major problem facing the Bulgarian economy and should be offset by a budget surplus of at least 3% of gross domestic product (GDP), which equals around EUR 700 million.¹ The IMF forecasts that the CAD will reach 13.8% of GDP in 2005 and if it exceeds this limit, it should be accompanied by additional budget savings. Along with it

¹ According to the forecast in the state budget

measures directed toward restricting the credits by the Bulgarian National Bank (BNB) are taken following the IMF recommendations.

Reducing budget spending is positive and should be welcome. However, the attainment of a budget surplus means that in the current ineffective public spending, which costs too much, the government has taken from the citizens more money than needed. This happened in 2004 when the surplus was around 1.7% of GDP and will happen in 2005 (the provisional surplus at the end of October is around EUR 840 million or above 3.9% of expected GDP and will probably be around 2% of GDP in the year-end). The IMF official insists on the same development for 2006.

This policy of budget surplus is improper as it deprives people and companies of their own incomes produced by themselves and gives the government an opportunity to use the money following its purposes, which could be very different from the people's. On the one hand, additional money taken restricts consumption, which is one of the IMF's targets, while on the other it does not allow for some investments that could have a positive effect on the production in the country. It substantially influences not only the demand side, but also the supply side. Temporary lower consumption is on account of restricted chances for longer-run growth in supply.

Let us consider the dynamics of goods import according to latest the BNB data for October 2005. The analysis, made on annual basis, shows that the increase in consumer goods import is around EUR 409 million compared to the previous period. It constitutes about 13 percent of the total increase of imports. Investment goods import grows with about EUR 1 012 million or 32 percent of the total increase, the rest due to raw materials (24 percent), mineral fuels, oils and electricity (30 percent), and other goods (1 percent). As Bulgaria is relatively poor in terms of natural resources, its economy needs to import them to operate. After the importation, the goods are processed and a large share of them is used in the production of exported goods. For example, the increase in energy resources is about EUR 940 million that should be put together with the increase in the energy export with EUR 405 million, and higher oil prices for the period should be taken into consideration.

Therefore, the current account deficit implies that the economy works, attracting capitals and the total balance of payments measured by the change in the foreign currency reserves of the country is well above zero. The IMF officials' concern about this is related to the rise in the private foreign debt. Reasons for this development can be found as a result of the application of their recommendations. On the one hand, BNB has taken restrictive measures against credit growth and on the other hand, the government takes more money from companies and households. Given the higher economic activity at present, demand for credits is directed out of the banking system and out of the country leading to a rise in foreign debt.

However, some of the IMF's advice brings benefits to the economy. Cutting budget spending, reforming some sectors, and buy-backs of foreign government debt are recommendations that should be followed. Reforms in education and the healthcare systems are delayed leading to rising ineffectiveness, worsening quality of the services' and higher costs. In these circumstances, the teachers' demands for higher wages are an example of how one well-organized societal group, knowing its interest, can seek rents by the state to increase its prosperity at the account of the taxpayers. The number of students has decreased due to the lower birth rate and emigration but the result is not a reduction in number of teachers and maintenance costs for education. Higher wages should follow a higher quality of education or the respective service that is provided.

One should note the practice of granting a thirteenth wage to the budget employees. It is completely improper because the source of the funds is not the budget itself, but private sector employees. They have worked more during the year, they have generated more incomes and they deserve to be rewarded for their labor and entrepreneurship. But this reward is taken away coercively through taxes and is given to other people whose contribution is very difficult to measure. A possible resolution of this case is to refund money back to the people by check, a practice which is applied in some countries. However, this enables the government to realize large budget surplus again in the next year, which probably will happen in 2006 when the revenues will exceed the plan by at least EUR 500 million.

A better decision is a reduction of the tax burden via the introduction of a 10 percent flat tax on

personal income, a 10 percent tax on the corporate profit and a 10 percent payroll tax. IMF officials would probably disagree but this is the way to create more incentives for people and companies and to boost the supply side. Tax reform should be combined with change in education and healthcare, in the judicial system and with relief in the business environment. Only reforms that expand economic liberty enable faster economic sustainable development, which is necessary for relatively poor countries like Bulgaria.

The precautionary agreement with the IMF expires in the second half of 2006 but this does not mean that the cooperation will be ended. It will be carried out in changed conditions implying weaker influence by the Fund on the government and central bank policies. In such circumstances, the prudent fiscal and monetary policies attain greater importance and the implementation institutions should realize that the justification with the IMF for some inappropriate actions would no longer be applicable.

On International Investment Climate in Bulgaria and Strategies for Attracting Foreign Investments

Adriana Mladenova, Dimitar Chobanov

At the December 7th meeting of the Council for Economic Growth a report entitled “Analysis of international investment climate and Bulgaria foreign direct investment experience and opportunity” was presented. The report was introduced by *Deloitte Bulgaria* and commissioned by the *Bulgarian Ministry of Economics*.

The main conclusions of the report can be summarized as follows:

1. Foreign Direct Investments (FDI) are a main factor for economic growth in Bulgaria as they have a direct positive impact on gross domestic product (GDP) in the country and stimulate opening of new work places and transfer of technology innovations, know-how and management and operational knowledge and skills.
2. According to the analysis, few in number but comparatively large investments form the volume of the annual FDI flows in Bulgaria, which makes the economy vulnerable to external economic performance and the investment climate abroad. The creation of new stimuli is necessary for attracting bigger investors in the country.
3. The competitive advantages of the Bulgarian economy in attracting FDI are:
 - Natural resources availability
 - Work force –presence of skilled and affordable workforce as the average wages are low in the country
 - Macroeconomic and political stability as a result of NATO membership and the prospective EU accession
4. The disadvantages of the Bulgarian economy concerning its ability to attract FDI are:
 - Investment climate – the level of the administration services is unsatisfactory and still lacking enough transparency; there are many regulations and bureaucratic procedures for starting and doing business in the country
 - The internal market in Bulgaria is relatively small
 - The country’s location is remote from the markets in Central and Western Europe and at the same time the infrastructure is not fully developed
5. Three economic sectors are proposed as being “targeted industries” and should be referred to as priorities in attracting FDI. These are:
 - Mechanical and Electrical Engineering/Machinery
 - Information and Communication Technologies (ICT)
 - Business Process Outsourcing (BPO)
6. The strategies for overcoming the competitive disadvantages should include the following mechanisms:
 - The incentive scheme for investors should be reconsidered and the

following mechanisms should be introduced: more subsidies and grants, privilege credits, government guarantees for investment credits, export guarantees and insurance;

- There should be a compensation of the investors for the disadvantages in Bulgaria and the targeted industries should be stimulated;
- Education and training should be improved by pre-qualification of the unemployed and stimuli for companies who improve the qualification of their employees and staff.

Our comments

Analysis of the FDI as a factor for economic growth

The attraction of foreign investments is the result of the advances of the economy and the presence of profitable investment opportunities. However, a factor for economic growth is not the money inflows of FDI, which increase the country GDP statistically, but the accumulation and creation of capital – physical, human and institutional – which leads to enhanced labour productivity. Technology renovation and capital accumulation in the economy can be financed by (1) savings in the economy, that is the postponing of present consumption for more in the future and (2) attracting savings from foreign economies which means attracting of FDI.

From this point of view, the privatisation of government assets is a positive phenomenon as long as favourable conditions are being established for the development of entrepreneurship and efficiently managed enterprises while at the same time distribution of income by the central government is lessened. However, cash flows coming from the sale of government enterprises are not a factor for economic advance because in these ways already existing capital is being bought. Of course, the follow-up modernization of the enterprises, the adoption of know-how and innovation and investments in new technological capacity enhance economic growth because they lead to the creation of more factors of production. Therefore the lack of large privatisation deals as a result of the exhaustion of assets for privatisation should not be taken as a threat for the economy, just the opposite. The increase of the private sector share is by itself a

prerequisite for the attraction of investors and doing profitable business in the country.

The other types of foreign direct investments – green field investments and mergers and acquisitions are a direct result of the investment opportunities that spring up in the country and unutilised market niches. Their significance for the economy should be evaluated through the prism of factors of production and the potential opportunities for business in the country.

Stimulation of FDI Inflow in Bulgaria

The attraction of investments in Bulgaria should not be an end in itself. In particular, non-market incentives distort the market signals and lead to non-equilibrium in the economy that turns into recessions in the middle-run. Optimal utilization of the competitive advantages of the economy can be accomplished through private initiative, voluntary exchange, and observance of property rights. Only the free laissez-faire market can “determine” which are the most profitable industries through coordination between the economic actors and via the information signals of the prices and the market processes.

The proposed measures in the report for the stimulation of investments in Bulgaria (giving of subsidies and all kinds of preferences from the government to specified “targeted” industries) will have a negative impact on the economy and undesirable effects on the business environment. Preferences distribution and the lack of equal treatment of investors will lead to the following results:

1. Some of the investors will draw back as they, not being among the targeted industries investors, will not receive equal treatment. This creates a certain degree of unpredictability in the investment environment as a result of the government intervention;
2. Some investors will be attracted to the selected industry not for economic reasons but as a result of the implementation of the proposed incentives. The eyes of some businessmen will be redirected from seeking of good business ideas to seeking of opportunities for preferences (rent-seeking);
3. The increase of income redistribution and an attempt to plan and regulate the development path and economic activity in the country.

4. Resources taken out from taxpayers for distribution of grants and privileges have an opportunity cost. The missed opportunities for economical and cost-efficient utilization of the means should be calculated and considered as a cost and missed benefits for the economy.
5. Increase of bureaucracy and thus more resources will be needed for its maintenance and at the same time conditions for increased corruption will be established.
6. The preferred sector is such that the government treats it as a priority for the sake of the other industries. In fact the proposition of several targeted industries supposes that the other ones are considered non-preferred - and thus their development should not be stimulated only because the "state" and its consultants think that they are not important enough.

The market is a process of the coordination of entrepreneurial efforts to fulfil the needs of consumers at most with the scarce resources that are available to them. Planning should happen only on a firm level and defining of targeted industries by the state is a senseless exercise and even harmful one when it is followed by attempts to change the economic policy in the country.

Measures that should be undertaken in order to stimulate foreign direct investments and the economic activity in the country should be directed towards more economic freedom:

1. Lowering of the tax and social security burden in the economy.

It is pointed out in the report that Bulgaria has one of the lowest tax rates on corporate income in Europe (15%) so incentives different than fiscal ones should be created in order to attract foreign investors. In fact, the overall tax and social security burden in the country is higher than the direct competitors of the state - Romania and Croatia. The share of the redistribution of income via the government budget (about 43%) is also among the highest ratios. For example, the ratio for Romania is under 35%. This clearly shows that fiscal incentives are one of the fair means for

equal treatment of the entrepreneurs - Bulgarians as well as foreigners.

A concrete measure that would stimulate investment inflows is the introduction of the promised zero rate on reinvested income. Estonia is already doing well with this fiscal incentive.

2. Decreasing of bureaucratic obstacles and implementation of a "single counter" administration, lessening of the licence regimes from 39 (their number at present) to 5. Also, the silent consent principle should be well established for all registration regimes. The procedures of opening a firm should be eased and the whole process should become available through the Internet.
3. Privatisation of the state-owned companies and other government assets such as forests, land, etc.; liberalization of the markets and abolishment of all kinds of obstacles on free trade.
4. Reformation in the education system via the introduction of vouchers and fostering of competition among schools. The proposed measures for education improvements in the country in the report sound as abstract as good wishes but fail to give a full picture of the situation and propose a sound solution to the existing problems. Through greater competition among schools and universities, people will become better prepared in the sphere of languages learning and will become more familiar with new technologies and management skills that are being evaluated as a prerequisite for FDI inflow. Only through the private establishment of the supply of education can a more reliable connection between schools and employers be established.

It is neither logically based nor economically proven that the increase of FDI should become for the sake of the local business and as such targeted industries cannot be defined for attracting investments. Marketing of industries is not in the usual scope of government operations and the proposed strategy contradicts to the main purpose of the state – to protect property rights and assure equality among all citizens before the law and the legitimately established rules.

Inaction In Action: The Court of Auditors, European Commissioners, and the Problem of Financial Mismanagement

Kevin Allen

Citing concerns regarding “errors of legality and regularity” regarding the accountability of community funds, the European Court of Auditors refused to sign off on the E.U. budget for the 11th consecutive year. Over the past decade, the Court has repeatedly uncovered examples of poor accounting practices among member states and has recently suggested that the underlying cause of these errors is a lack of proper implementation and administration of the Integrated Administration and Control System (IACS) at the national level. While there is some validity to these assertions, the problem is a multi-faceted one and it would be remiss to assume that fault rests exclusively with actions of the member states. The prevailing problems stem not only from the fiscal mismanagement of the various member states but from the IACS, the Court’s inability to properly measure mismanagement and from the actions of the Commission itself.

IACS

To understand such a contention, it is first necessary to understand what the IACS is and how it is supposed to work. Time constraints prevent me from offering a comprehensive synopsis of the system and as such I will cover only the primary components. The IACS is comprised of 5 key elements which when implemented properly, will purportedly curb the misuse of structural funds.

The first of these components consists of a computerized database whose primary function is to record data for each (land) holding. The database is seen as essential for payment processing, crosschecking, the application of sanctions and management in general. It can be decentralized however it is necessary for member states to use compatible systems and the reality is that multiple systems are often used depending on the structure of the member state².

The second component of the IACS is comprised of a land parcel identification system.

Functions of this component include payment processing, checking claimed areas, checking for duplicate claims for the same parcels and carrying out on the spot inspections. One of the primary shortcomings of the parcel identification system is that it does not require information regarding land usage and the lack of such information opens the door for fraudulent claims.

The third focuses on animal identification and registration via herd registers and ear tagging. It further adds requirements for the computer database and the issuance of animal passports. According to the Court, this facet is necessary for checking the eligibility of animals claimed, checking for duplicate claims, and the verification of ownership.

The fourth component concerns applications for aid. The system stipulates one application per farmer while allowing for several animal premium applications. Applications are deemed to be essential for the provision of basic information on the areas or animals claimed.

The final element of the system is the integrated control system whose functions are to perform cross-checks between farmers and land/animal claims, to verify the eligibility of claimed areas (surface size of parcels, age of animals, etc.) and to instill checks to avoid overpayment.

While there are a number of issues with the IACS, the most glaring problems are tied to incompatibility amongst databases and the use of multiple systems. The potential for error due to incompatibility raises serious concerns regarding the effectiveness of the database. The problems are exacerbated when animal registration and identification is tied to these structures. Furthermore, it is imperative that the Court requires claimants to provide information regarding land usage. Intuition dictates that both a uniform database system and a comprehensive knowledge of applicants are necessary precursors to the reduction of fraudulent claims.

Issues of Measurement

Other issues correlated with the Court lie in their inability to accurately measure fraudulent transactions. The annual report put forth by the Court is laden with statements which testify to the aforementioned assertion.

- Currently the IACS only accounts for approximately 63 percent of the Common Agricultural Policy budget. According to the Court, CAP expenditures amounting to roughly

² 3rd EUROSAT Training Event – Evaluation of Internal Control Systems. Prague, Czech Republic-2003.

www.nku.cz/seminars/Prague_2003/m8.ppt

EUR 43.6 billion have been ‘materially affected by errors.’ Looking at these numbers one can assume that there are still some EUR 70 billion worth of expenditures that have not been properly accounted for.

- Regarding the reliability of the accounts, the Court report notes that ‘in the absence of effective internal control procedures for miscellaneous revenue and advances, the Court cannot be certain that the transactions relating to the sundry debtors item have been correctly and completely recorded.’³
- In respect to sundry debtors, the report contends ‘the recording of sundry debtors continues to pose problems’ while later adding ‘..in the absence of a suitable accounting system, the Court is unable to give assurance as to the accuracy and completeness of the amounts entered as held by financial intermediaries.’
- In regard to internal policies the Court found that despite progress in some areas, there exists a number of weaknesses in regard to supervisory and control systems as well as errors in transactions at the beneficiary level. It contends that such errors will continue unless the legal framework is changed in a manner that simplifies cost reimbursement systems and clarifies procedures governing the different programs.

While it is undoubtedly an onerous affair to measure such a large number of transactions, it is crucial that the Court be able to accurately monitor all financial transfers. By neglecting to reform its own system in lieu of a legislative overhaul, the Court is failing to effectively fulfill its function and consequently doing a disservice to the tax-paying citizens of the E.U.

Problems concerning the Commission

As previously mentioned, the Court is not sole at fault. It is necessary for member states to hold themselves accountable and ensure that community funds are properly spent. At a recent meeting of finance ministers, current president Gordon Brown of the United Kingdom rejected a request by the Commission that required finance ministers of member states to personally sign off on their country’s spending. Such irresponsible behavior by leading members of the Commission not only contributes to the problem but also sets a poor example for both newer members and current candidates. It is

absolutely essential that those member states that have more experience behave in a fiscally ethical manner and unfortunately this has not been the case in recent years.

For example, in 1999, former French prime minister and European Commissioner Edith Cresson was under investigation for misappropriation of E.U. funds after she hired Rene Berthelot as a consultant. In total Berthelot received payments of approximately BEF 5.5 million despite the fact that his qualifications did not correspond to the various posts to which he was assigned⁴. In the same year, allegations of fraud and mismanagement led to the resignation of European Commission President Jacques Santer and 19 other Commissioners.

The pervasiveness of this financial mismanagement can be seen in the *1st Report on Allegations Regarding Fraud, Mismanagement and Nepotism in the European Commission* where, in the concluding remarks the report states: ‘Undoubted instances of fraud and corruption in the Commission have passed unnoticed at the level of the Commissioners themselves.’

Conclusion

In sum, the irregularities mentioned by the Court as the reason for failing to sign off on the E.U. budget are the function of a variety of shortcomings. Of these shortcomings, the most predominant is concerned with the effectiveness of the database. Although the Court places the blame squarely on the member states and their failure to properly implement the system, one can easily see that the root of the mismanagement problem runs much deeper. The very fact that the Court has failed to sign off on the budget for such a lengthy period of time leads to questions surrounding its’ ability to curb the misuse of E.U. funds. This is further evidenced by the British member of the Court, David Bostock, who suggested that the IACS had reduced the risk of error for most E.U. agricultural expenditures to an acceptable level. There is undoubtedly a need for very serious reform when EUR 43.6 billion of CAP expenditures which have been marked as ‘materially affected by errors’ constitute an acceptable level.

³ European Court of Auditors – 2004 Annual Report.

⁴ 1st Report on Allegations regarding Fraud, Mismanagement, and Nepotism in the European Commission- March, 1999.

Even more disturbing is the lack of accountability and responsibility by Commissioners at a national level. Allegations of fraud at the highest level of the Commission speak to the pervasiveness of the problem while the failure to sign off on their own countries spending suggests that Commissioners are not willing to seriously address the problem. One cannot expect ethical behavior at lower levels of the E.U. when the highest-ranking members are engaged in corruption and neglect to take responsibility for their own unethical conduct. This is perhaps best summarized by a comment in the *1st Report on Allegations Regarding Fraud, Mismanagement, and Nepotism* which states: 'Protestations of ignorance on the part of Commissioners concerning problems that were often common knowledge in their services, even up to the highest official levels, are tantamount to an admission of a loss of control by political authorities over the Administration that they are supposedly running. This loss of control implies at the outset a heavy responsibility for both the Commissioners individually and the Commission as a whole.'

Still, there are a number of questions which remain unanswered. Who are the primary actors responsible for these losses? Can we assume that member states who receive more funding are more likely to lose money in the bureaucratic shuffle? If this is a rational line of thinking then the two largest recipients, Germany and France, would be responsible for the greatest portion of mismanaged funds.* Why is the European public not outraged at the fact that such massive amounts of money are being wasted and what can be done to draw greater attention to the problem? Until the Court of Auditors makes a concerted effort to engage in serious and comprehensive reform and until members of the Commission make a resolute attempt to rectify this problem, tax-paying citizens of E.U. member states will continue to lose their money to self-serving con artists and negligent bureaucrats.

* ¹ 3rd EUROSAT Training Event – Evaluation of Internal Control Systems. Prague, Czech Republic-2003. www.nku.cz/seminars/Prague_2003/m8.ppt

Petition

to the national governments of the European Union member states, the European Council, the European Commission and Members of the European Parliament

December 1, 2005

Excise duties are partially harmonised in the European Union (EU) – minimum excise requirements are set for alcohol, tobacco and energy products, and the new EU member states have committed to reach these minimum levels. However this task is getting increasingly burdensome for the consumers, businesses and government institutions of the new member states.

We, the undersigned, state that failures of partial excise harmonisation reveal inherent flaws of tax harmonisation: societies are prevented from having lower taxes, smaller and more efficient governments; member states have limited opportunities to adapt to their unique social, economic and geographic conditions; and national governments are shielded from potential competition amongst them. Therefore we

encourage launching an EU-wide debate on the reform of the excise tax policy and considering an abolition of the minimum level of the excise duties.

Surging fuel prices and smuggling activities have disclosed the natural shortcomings of the excise tax. There is no agreement whether the excise tax is efficient and necessary to internalise the negative externalities of consumption. The application of excise duties itself causes significant negative externalities: consumers opt for cheaper and lower- quality substitutes, administration of excise duties is costly, differences in prices provoke smuggling and high excise duties hit the most hard on the poorest strata of society. Furthermore, availability of smuggled alcohol and tobacco substitutes completely undermines the objectives of the public health policy.

Excise duties constitute up to 80 percent of the price paid by consumers, thus heavily distorting market information about the supply and demand as well as long-term prospects and needs to adapt to changes in the market. The abolition of the minimum level of excise duties and the reduction of excise tariffs are long-term

measures in order to help the consumer to adapt to the changes in the market.

Harmonization of excise duties fails to attain its objectives: differences in prices across EU member states remain considerable, a number of exceptions for different products are laid down in laws, collision of wine-producing countries and the remaining member states demonstrates the narrowness of the goals set for the excise policy, and different tariffs of excise duties among member states are tolerated by the EU itself as they do not distort the competition and the internal market. Minimum levels of excise duties were revised before the last EU enlargement took place; these levels were designed to meet the living and income standards in the EU-15 and proved to be too burdensome for Central and Eastern European countries.

We believe that it is internal competition and the four freedoms, not uniform taxes, create the common market.

High prices of the excised goods and their decreasing affordability stimulate smuggling into the new EU member states who administer the longest part of EU's external borders with

poorer EU neighbours, which is a considerable incentive for smugglers. Although smuggling serves consumers and buffers an increase in prices, it creates openings for corruption in the customs, the police and other government institutions. According to surveys conducted by Transparency International, border services of Eastern Europe remain exceptionally sensitive to corruption despite substantial funding and training from EU provided to secure the external border of the EU.

Governments of the EU-15, which have excise taxes high above the minimum level, should show due attention to the scale and importance of the problems faced by the new members of the club.

We urge national governments of the European Union, the European Council, the Commission and the European Parliament to take necessary steps to open debates on the excise tax reform and endorse an abolition of the minimum level of excise duties as the first need step.

Respectfully,

Lithuanian Free market institute

*THE BRUSSELS DECLARATION**

1. We uphold the values that have always defined European civilisation: personal freedom, private property, parliamentary democracy and the rule of law.
2. We recognise that the richness of European culture lies in diversity, variety and pluralism.
3. We fear that, in its pursuit of ever-closer union, the EU is progressively abandoning these values.
4. We posit a new and better European dispensation, in which power is exercised the lowest practical level, and in which decisions are taken as closely as possible to those they will affect.
5. We acknowledge the special loyalty that citizens owe to their nations, and believe that the primary democratic unit should be the sovereign state.
6. We support a broad and loose European association, in which all European states can comfortably participate.

7. We believe that, within the constant nexus of a European free market, states should be free to integrate to the extent that they wish, and in such combinations as they please.

8. We want to limit the jurisdiction of international institutions to cross-border issues.

9. We confirm our commitment to the Atlantic alliance, and look forward to a world without blocs, in which European nations take their place as part of the wider Western family.

10. We pledge ourselves to work, in our home countries and in the forums and councils of Europe, for the achievement of these goals.

*Adopted at a meeting of members of the European Parliament and representatives of free market think tank, held in Brussels, on December 5 and 6, 2005. Two IME associates, Krassen Stanchev and George Angelov, took part in the meeting. Enclosed is the FT Europe account of the meeting.

Rightwingers unite in bid to clip Brussels' wings

By Andrew Bounds in Brussels
Published: December 7 2005 02:00

Europe's rightwing politicians, led by members of the Conservative party, launched a transnational movement yesterday in favour of reducing the European Union to a loose economic area.

The move coincides with the election of David Cameron as leader of the Conservative party.

Mr Cameron has pledged to pull his party out of the continent-wide integrationist European People's party and establish a new eurosceptic grouping.

In Brussels, 18 members of the European parliament and about 50 other participants from 30 countries, including eurosceptics from US think-tanks, pledged to support the creation of a free market area with powers only over cross-border issues.

Daniel Hannan, a Conservative MEP, who organised the meeting, said: "There have always been people criticising the EU. What there has never been is an alliance of people who can agree on a mainstream, positive alternative."

Mr Hannan estimated that up to 70 MEPs could join the Alliance for an Open Europe, making it the fourth-largest grouping in the European parliament. Others believe that is optimistic. The parliament has 732 members, and the European People's party has 267.

Many of those attending took part in campaigns to oppose the recent European constitution, which was defeated by referendums in France and the Netherlands.

Vaclav Klaus, the Czech president and the only EU leader to oppose the constitution, was chosen to be the "patron" of the alliance.

"What inspired this is the fact that many parts of the constitution are being implemented anyway," said Mr Hannan. He cited the EU's fledgling diplomatic service and its defence agency as examples.

Yet there are doubts about how many allies Mr Hannan can muster. Mr Klaus's ODS party is not expected to commit itself until after elections in June.

Poland's governing Law and Justice party sits with virulent eurosceptics and has a protectionist bent.

Anthony Nelson, a former Conservative minister and chairman of Britain in Europe, the pro-European pressure group, condemned the "isolationist" plan that would reduce British influence over regulations.

Mr Nelson, who is vice-chairman of Citigroup, said: "A new Tory leader should occupy the centre ground and be inclusive not exclusive. Anything that isolates us from Europe cannot help, and defend our financial services industry, which is vital to our prosperity."

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